
OFFICE OF THE INDEPENDENT BUDGET ANALYST REPORT

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Information Technology Sourcing Strategy

OVERVIEW

On December 6, 2010, the City Council will be requested to accept the Information Technology (IT) Sourcing Strategy prepared by Avasant, LLC, as authorized under Phase 1 of their contract which was executed by the Mayor in September 2010. Phase 1 costs totaled \$231,000. Council will also be asked to authorize additional expenditures of up to \$392,000 to allow Avasant to move forward with the next optional phases in their contract, funding for which is available in the FY 2011 Information Technology Services budget:

- > Phase 2 - Up to \$150,000 for development of the Request for Proposals (RFP) for IT services;
- > Phase 3 - Up to \$242,000 to assist with vendor selection, negotiation and transition.

Given that this combined expenditure will exceed the Mayor's contract authority of \$250,000, City Council authorization is required for execution of Phases 2 and 3. The Mayor is not required, however, to seek Council approval of the Sourcing Strategy. The Mayor is doing so in response to a recommendation of the IBA and request of the City Council last April that the legislative branch be involved early in the procurement process for IT services, prior to issuance of the RFP.

BACKGROUND

Soliciting proposals for outsourcing the City's IT Services is one of ten major fiscal reforms that the City is pursuing in addition to numerous other strategies and solutions-

all aimed at reducing the overall cost of service and eliminating the City's structural budget deficit. The San Diego Data Processing Center (SDDPC), a non-profit corporation formed in 1979, is currently providing the bulk of the City's IT services. It is expected that SDDPC will compete in this procurement process. The dollar value of the IT services that have been identified as suited for outsourcing totals \$37.2 million. As indicated in the Sourcing Strategy, and based on the City's recent experience with outsourcing the IT Help Desk, the potential exists for significant annual savings as a result of this competitive process.

The City's initial step in outsourcing the City's IT services took place in April 2010 with Council approval of the Mayor's recommendation to award a one-year contract with two two-year extensions to En Pointe Technologies for IT Help Desk and Desktop Support Services. Previously these services had been provided by the San Diego Data Processing Corporation (SDDPC). Through this outsourcing process, the City is estimated to reduce its' annual costs for these services by \$1.1 million annually beginning in FY 2011. This represents a 47% savings over the FY 2010 budgeted amount of \$2.7 million for these same services.

In April, the IBA issued report #10-33, "Help Desk and Desktop Service Request for Proposals", which recommended that the Council approve the agreement with En Pointe. In anticipation of the larger IT services procurement and to ensure earlier Council involvement, we also recommended that the Mayor obtain Council review and approval of the RFP's associated with the next phases of procurement of IT services, prior to their issuance. The Council- adopted motion modified this recommendation to request the Mayor to bring back a strategy for outsourcing of IT services prior to the release of any additional RFP's for IT services. The Mayor is seeking Council's acceptance of the completed IT Sourcing Strategy in response to this request.

The Mayor is further seeking Council's approval to move forward with Phases 2 and 3 of the Avasant contract totaling \$392,000 as it exceeds Mayoral contracting authority which is capped at \$250,000. For Phase 2 Avasant will be assisting with preparing the actual Request for Proposals; during Phase 3 Avasant will assist with vendor selection, negotiations and transition. While this is a significant consulting contract, IT services are complex and costly; and the potential savings upon completion of a successful procurement process are significant. These expenditures were anticipated in development of the FY 2011 budget and funds are available within the IT Services budget.

DISCUSSION OF IT SOURCING STRATEGY

In seeking Council acceptance of the completed IT Sourcing Strategy prior to development and issuance of the RFP, the Mayor has provided an opportunity for the Council to weigh in on a number of significant issues and to help set policy direction to guide this major procurement process. Highlighted below are key issues for consideration either discussed in the Sourcing Strategy or raised by Council members during the Help Desk outsourcing process.

Service Delivery Options (P. 45)

Drawing from industry standards and Avasant's experience with other public and private sector clients, the Sourcing Strategy presents four sourcing options (listed below). Each of the recommended options was evaluated for associated risks and financial considerations. However, Avasant did not analyze the fiscal considerations associated with Option 3 because they did not consider it to be viable based on their analysis.

- Option 1** Base case – continuing service as is with SDDPC
- Option 2** Exclusive negotiations with SDDPC for improved service model & cost structure
- Option 3** Insourcing all IT services with City staff
- Option 4** Contracting for managed IT services

Projected Annual Cost Savings (P. 53)

Assuming service transition will begin in September 2011, Avasant estimated total costs for Options 1, 2 and 4 from Fiscal Year 2012 through Fiscal year 2019. Cost estimates for Option 4 were divided into two resource delivery options: 1) all onshore resources and 2) combination of onshore and offshore resources. The IBA was informed that onshore means resources procured within the County of San Diego. Staff plans to allow proposals to show other business models using resources from outside the County; however, they must provide an in-County proposal so that price differences can be compared.

Based on the City's requirements, and the potential for savings and the risk analysis considering associated risks, Avasant is recommending that the City move forward with contracting for managed IT services. The table below shows the projected annual savings over the Base Case for each of the options evaluated by Avasant:

		<u>Projected Cost Savings Over Base Case</u>		
<u>Fiscal Year</u>	<u>Option 1 Base Case</u>	<u>Option 2 SDDPC</u>	<u>Option 4 (A) Contracting</u>	<u>Option 4 (B) with Offshore</u>
FY 2012	\$37,666,024	\$805,732	-\$850,270	\$413,741
FY 2013	\$38,081,737	\$2,482,509	\$1,384,987	\$4,226,752
FY 2014	\$38,505,765	\$2,883,642	\$5,345,123	\$8,055,557
FY 2015	\$38,938,272	\$3,071,088	\$6,282,632	\$9,705,650
FY 2016	\$39,379,430	\$3,227,987	\$7,139,321	\$10,956,019
FY 2017	\$39,829,411	\$3,349,802	\$7,796,940	\$11,489,692
FY 2018	\$40,286,397	\$3,429,340	\$8,334,035	\$11,900,162
FY 2019	<u>\$40,750,528</u>	<u>\$3,607,142</u>	<u>\$8,756,460</u>	<u>\$12,305,688</u>
	\$313,437,564	\$22,857,242	\$44,189,228	\$69,053,261

Displaced City/SDDPC Employees (P. 35)

The Sourcing Strategy has identified 28-35 key/critical IT personnel who have “lengthy and deep knowledge of the City of San Diego’s department business processes and systems.” City departments have expressed concerns about losing employees who they deem as key to their business operations; and this is considered a potential risk particularly in the early stages of transition. The Sourcing Strategy recommends the following:

“To ensure continuity of service, the City of San Diego should consider requiring the Service Provider to take on Critical Personnel that will be identified in the RFP.”

This requirement would be consistent with existing Council policy direction on the matter of displaced employees as well as language contained in the Managed Competition Guide which requires contractors to give first preference in hiring to displaced City employees.

Onshore/Offshore Service Delivery (P. 43)

The issue of onshore/offshore delivery was an issue in the Help Desk outsourcing process where the successful vendor had originally proposed to provide the majority of services in San Diego with a portion of the services to be provided offshore. The vendor also provided the City with a proposal for 100% onshore services which is the service delivery model ultimately selected by the City. The Sourcing Strategy contemplates that the City require providers to provide a 100% onshore proposal but also allow alternative scenarios to be submitted for utilizing some offshore resources. Staff has informed the IBA that onshore for this process means resources procured within the County of San Diego. Avasant notes that for an IT environment as large as the City’s, the use of 10% offshore resources could translate into a \$250,000-\$500,000 savings. We concur with allowing both options to be submitted for evaluation.

Length of Contract Term (P. 44)

The Sourcing Strategy discusses pros and cons of two optional contract terms of 1) less than five years or 2) five years or greater. Based on Avasant’s advice, staff is considering a five-year contract with two one-year options.

Single RFP/Multiple RFPs (P. 55)

Prior to the Avasant study, consideration had been given to issuing multiple RFPs representing separate components of the City’s IT services. Avasant is recommending that a single RFP be developed that will allow for providers to bid on some or all of the three IT components which include the Data Center, Application Support and Network/Telecommunications. The City will reserve the right to award on a function by function basis or a bundled basis based on best value.

Prime Providers/Smaller, Local Providers (P. 58)

In the past the Council has expressed strong support for both local hiring and the development of small, local businesses. In the section on Provider Qualification, the Sourcing Strategy acknowledges this policy direction:

“In choosing a provider (s), the City must strike a balance between ensuring that only those providers that can reasonably perform the requested services are considered, while on the other hand encouraging opportunities for smaller and/or local IT companies to be involved.”

The Sourcing Strategy suggests that the RFP be written to include language that encourages larger “prime” providers to consider sub-contracting with smaller, local IT service providers. Council may want to discuss with the staff and the consultant the pros and cons of **requiring** this of providers rather than simply **encouraging** it.

Timetable for IT Outsourcing (P.56)

According to the Avasant study, the RFP is scheduled to be issued in mid-February 2011. Contract negotiations with the winning provider(s) are expected to be completed in June 2011 followed by Council Committee and full Council actions in July and September 2011 respectively.

Vendor Transparency (Not addressed)

In the past Council members have raised issues relative to vendor transparency such as vendor requirements for providing the City access to their records pertaining to the specific services or requirements for responding to Public Records Act requests. The Council may want to discuss with staff and the consultant how this issue will be addressed in the RFP.

CONCLUSIONS AND RECOMMENDATIONS

Based on our review of the Sourcing Strategy, the IBA recommends City Council acceptance of the overall strategy which lays out a plan for moving forward with competitively outsourcing the City’s IT services as identified in the report. The IBA recommends, however, that the Council use this opportunity to provide clear policy direction to the Mayor on development of the RFP with respect to issues highlighted in this report and to clarify with staff and the consultant any other areas of concern. The Mayor is not required and does not plan to bring the RFP back to City Council for review. Alternatively, he has provided this opportunity for Council to weigh in on the RFP prior to its development.

The IBA further recommends Council approval of Phases 2 and 3 of the Avasant contract not to exceed a total of \$392,000. While a significant expenditure, this is a complex work effort with potential for significant cost savings far greater than this initial investment.

The next step requiring City Council action is award of contract(s) scheduled for Committee in July 2011 and full City Council action in September 2011.

[SIGNED]

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